

Private Letter Ruling: Subsidiary is a sales finance company which cannot be combined with non-financial organizations.

December 23, 1999

Dear:

This is in response to your letter dated November 30, 1999, in which you request a Private Letter Ruling on behalf of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Ill. Adm. Code Section 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to xxxxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxxxx for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither xxxxxx xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

1. xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx ("xxx") is a publicly traded xxxxxxxx Corporation commercially domiciled in xxxxxxxx. xxx is a holding company.
2. xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx ("xxxx") is a wholly owned subsidiary of xxx incorporated in xxxxxxxx and headquartered in xxxxxxxx. xxxx operates retail locations throughout the United States. These retail locations sell new truck trailers, used truck trailers, and parts for truck trailers. These locations also perform repair and maintenance services.
3. xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx is a xxxxxxxx limited partnership with its commercial domicile in xxxxxxxx. The partners of xxxxxxxx xxxxxxxxxxxxxxxxxxxx are xxxx, who is a 1% general partner and xxx, who is a 99% limited partner. xxxx manufactures truck trailers at facilities in xxxx, xxxxxxxx and xxxxxxxx. xxxx sells its manufactured product to xxxx and to unrelated third parties throughout the United States.
4. xxxx and xxxx each make credit sales and, therefore, generate accounts receivable in the normal course of their business operations. Some of these credit sales are made to Illinois customers.
5. xxxx, a wholly owned subsidiary of xxx, is a xxxxxxxx corporation currently commercially domiciled in xxxxxxxx. xxxx is a factoring company engaged in the purchase of accounts receivable for cash and without recourse, at an arm's length discount, from xxxx and xxxx.
6. xxxx sells undivided interests in the accounts receivable to an unrelated securitization company who is an affiliate of a bank. The interests are sold without recourse and at a discount.
7. Effective January 1, 2000, xxxx is contemplating the relocation of its commercial domicile from xxxxxxxx to Illinois.
8. Once established in Illinois, xxxx will continue to purchase accounts receivable from xxxx and xxxx at an arm's length discount. The discount will be based on the prevailing market rate of interest at the time of the sale, the due date of the account receivable, the creditworthiness of the customer groups,

the costs associated with the collection and the cash application process.

9. xxxx also has a servicing agreement with xxxx and xxxx, under which the employees of xxxx and xxxx provide credit and collection services at an arm's length charge.
10. The payments for receivables related to "xxxx's accounts receivables" are received at a drop box located in xxxxxxxx.
11. The payment for receivables related to "xxxx's accounts receivables" are received either via electronic funds transfer at a bank account located in Illinois or at a drop box located in Illinois.
12. xxx currently files an Illinois return as part of a unitary group, which does not include xxxx.
13. xxxx currently files a separate return from the "xxx unitary group" using a single sales factor since it is anticipated that it will be treated as a financial organization under Illinois income tax statutes.

Proposed Ruling [of the taxpayer]

The Company respectfully requests a binding PLR from the Department confirming:

- 1) That the xxxx would be treated as a "financial organization" under the IITA;
- 1) That xxxx's discount income arising from factoring of accounts receivable would be treated as interest income under the IITA;
- 1) That xxxx would be required to apportion its discount income from the factoring of accounts receivable based upon the following apportionment formula:
 - a) Interest income (discount income) receipts received at the Illinois lockbox from xxxx customers with commercial domicile in Illinois (if any) and plus interest income (discount income) receipts received at the Illinois lockbox from xxxx customers with their commercial domiciles in Illinois divided by total interest income (discount income) receipts received.
- 1) That xxxx would be required to file a separate Illinois income tax return and would not be included in the "xxx unitary return".

Analysis [of the taxpayer]

xxxx will be a financial organization under 35 ILCS 5/1501 (a)(8).

Section 1501(a)(8)(A) of the IITA provides that a "sales finance company" is a financial organization. Effective 1/1/00, Illinois Senate Bill 799 amended Section 1501(a)(8)(C) of the Illinois Income Tax Act (IITA) to define a "sales finance company" as... "a person primarily engaged in the business of purchasing customer receivables...". The IITA was further amended to define "customer receivable" as... "an installment, charge, credit, or similar contract or agreement arising from the sale of tangible personal property or services in a transaction involving a deferred payment price payable in one or more installments subsequent to the sale...". As previously

described, xxxx purchases customer receivables from xxxx and xxxx. These receivables meet the definition of "customer receivables" based upon the above-referenced amendment to the IITA. Furthermore, xxxx would be considered a financial organization on the date that xxxx is contemplating the relocation of its commercial domicile to Illinois under the amended IITA.

The Income Constitutes Interest Income under 35 ILCS 5/304(c).

To the extent that the amounts received by xxxx from xxxx's and xxxx's customers exceed the amounts paid by the xxxx for the respective accounts receivable, those amounts will be deemed interest income. In Illinois Private Letter Ruling 98-0007, the Department provided detailed guidance to a particular taxpayer confirming the Department's position that the income received by a factoring company would be treated as interest income.

The following analysis confirms both xxxx's and the Department's position that the income of a factoring company should be treated as interest income. Under federal tax law, interest is defined as "compensation for the use or forbearance of money." *Commissioner v. du Pont* 308 U.S. 488, 498 (1940). Under 35 ILCS 5/102, this definition of interest applies to the IITA.

Because xxxx will acquire all rights to payments on the accounts receivable and will assume all responsibility for the collection of the accounts receivable, the amounts received by xxxx in excess of the amounts it paid for the accounts receivable will constitute compensation in exchange for the use of the xxxx's money. This transaction will reflect the factors normally taken into account in determining the interest payable on an advance of funds. Consequently, such amounts constitute interest for purposes of the IITA.

The Sourcing of the Interest Income

Under 35 ILCS 5/304(c)(1)(C), interest income is allocated to Illinois only if it is from an Illinois customer and received in Illinois. The first question that arises from the facts of this case is whether the obligors on the accounts receivable become the customers xxxx. There is no statutory or regulatory guidance on this issue. However, the Department has previously issued a private letter ruling in a similar case that raised the same issue. See Ill. Priv. Ltr. Ruling 98-0007. In that case, the Department determined that when a factoring company purchased accounts receivable from an affiliated corporation, the corporation's customers became the factoring company's customers. The Department based its conclusion on the fact that the factoring company actually bought the accounts receivable, rather than making a loan to the affiliated corporation. In this case, xxxx will purchase the accounts receivable from xxxx and xxxx at an arm's length discount on a non-recourse basis. Once this occurs, xxxx will be financing the accounts receivable, and therefore, those obligors will be customers of xxxx.

Another question that must be resolved in determining the source of the interest income is the meaning of "Illinois customer" and "received in Illinois". There is no statutory or regulatory definition of these terms. However, in Illinois Private Letter Ruling 98-0007, the Department provided detailed guidance to a particular taxpayer on these issues. In that letter ruling, the

Department concluded that interest income would be allocated to Illinois if:

- (a) the customer is:
 - (i) an individual Illinois resident; or
 - (ii) a person (other than an individual) whose commercial domicile is in Illinois; or
 - (iii) (subject to rebuttal) any person whose billing address is in Illinois if [the factoring company] has no knowledge of the person's residence or commercial domicile; and
- (b) the customer's payment is:
 - (i) sent by a customer to a lockbox in Illinois; or
 - (ii) Transmitted by the customer electronically to a bank located in Illinois.

This determination is entirely consistent with subsection 304(c)(1)(C), which establishes when interest income will be allocated to Illinois and should be applied to xxxx's interest income apportionment.

Duty to File a Separate Illinois Return

Under 35 ILCS 5/502(a), xxxx, as a resident of Illinois, will be required to file an Illinois tax return. Under 35 ILCS 5/1501(27), xxxx, due to its status as a financial organization, as has previously been established, will be required to file a separate return.

Conclusion [of the taxpayer]

The following summarizes xxxx's conclusions with respect to the company's proposed activity in the state of Illinois as analyzed under Illinois income tax authority:

- (1) The business activity of xxxx in the state of Illinois is deemed to be that of a financial organization.
- (2) xxxx's income from the factoring of accounts receivable purchased, without recourse, from affiliates is considered interest income.
- (3) xxxx's interest income will be apportioned to Illinois based upon interest receipts received at the Illinois lockbox from xxxx customers with commercial domicile in Illinois (if any) plus interest receipts received at the Illinois lockbox from xxxx customers with their commercial domiciles in Illinois divided by total interest receipts received.
- (4) xxxx will file a separate Illinois income tax return.

Ruling

Qualification of xxxx as a Financial Organization

The Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) defines a "financial organization" as follows:

- (A) The term "financial organization" means any bank, bank holding company, trust company, savings bank, industrial bank, land

bank, safe deposit company, private banker, savings and loan association, building and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, investment company, or any person which is owned by a bank or bank holding company. For the purpose of this Section a "person" will include only those persons which a bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), except where interests in any person must be disposed of within certain required time limits under the Bank Holding Company Act of 1956.

See IITA Section 1501(a)(8).

Pursuant to Section 5 of Public Act 91-535, passed by ninety-first General Assembly and effective January 1, 2000, the definition under IITA Section 1501(a)(8)(C) of "sales finance company" was changed, in part, as follows:

(C) For purposes of subparagraph (A) of this paragraph, the term "sales finance company" has the meaning provided in the following item (i) or (ii):

(i) A person primarily engaged in one or more of the following businesses: the business of purchasing customer receivables, the business of making loans upon the security of customer receivables, the business of making loans for the express purpose of funding purchases of tangible personal property or services by the borrower, or the business of finance leasing. For purposes of this item (i), "customer receivable" means:

(a) a retail installment contract or retail charge agreement within the meaning of the Sales Finance Agency Act, the Retail Installment Sales Act, or the Motor Vehicle Retail Installment Sales Act;

(b) an installment, charge, credit, or similar contract or agreement arising from the sale of tangible personal property or services in a transaction involving a deferred payment price payable in one or more installments subsequent to the sale; or

(c) the outstanding balance of a contract or agreement described in provisions (a) or (b) of this item (i).

A customer receivable need not provide for payment of interest on deferred payments. A sales finance company may purchase a customer receivable from, or make a loan secured by a customer receivable to, the seller in the original transaction or to a person who purchased the customer receivable directly or indirectly from the seller.

In your letter you have represented that xxxx's business consists primarily of purchasing from xxxx and xxxx accounts receivable that were generated from credit sales made by xxxx and xxxx in their respective truck trailer businesses. The accounts receivable purchased by xxxx arise from the sale of tangible personal property, and are thus considered "customer receivables" under the new statutory provision, IITA Section 1501(a)(8)(C)(i)(b). Because xxxx is primarily engaged in the business of purchasing customer receivables, xxxx will be considered a sales finance company, and thus a financial organization for purposes of IITA.

Apportionment of xxxx's Business Income to Illinois

According to IITA Section 304(c)(1), the business income of a financial organization is generally apportioned to Illinois by the following rule:

Business income of a financial organization shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is its business income from sources within this State, and the denominator of which is its business income from all sources. For the purposes of this subsection, the business income of a financial organization from sources within this State is the sum of the amounts referred to in subparagraphs (A) through (E) following, but excluding the adjusted income of an international banking facility as determined in paragraph (2):

(A) Fees, commissions or other compensation for financial services rendered within this State;

(B) Gross profits from trading in stocks, bonds or other securities managed within this State;

(C) Dividends, and interest from Illinois customers, which are received within this State;

(D) Interest charged to customers at places of business maintained within this State for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts; and

(E) Any other gross income resulting from the operation as a financial organization within this State. In computing the amounts referred to in paragraphs (A) through (E) of this subsection, any amount received by a member of an affiliated group (determined under Section 1504(b) of the Internal Revenue Code) from another member of such group shall be included only to the extent such amount exceeds expenses of the recipient directly related thereto.

You have requested from the Department a ruling that income amounts received by xxxx from payments on xxxx and xxxx accounts receivable, in excess of amounts paid for the accounts receivable, will be identified as interest, and therefore sourced under Section 304(c)(1)(C) for purposes of apportioning xxxx's business income to Illinois.

The term "interest" is not defined in the IITA. However pursuant to IITA Section 102, the meaning for which a term is used for purposes of the Internal Revenue Code shall be the same meaning used for purposes of the IITA, unless expressly provided for otherwise. The United States Supreme Court has defined "interest" to mean "compensation for the use or forbearance of money" for federal income tax purposes. Commissioner v. du Pont 308 U.S. 488, 498 (1940). According to facts in your letter request, xxxx will continue to purchase accounts receivable from xxxx and xxxx at a discount, determined by taking into account the prevailing market rate of interest at the time of the sale, the due date of the account receivable, the creditworthiness of the customers, and the associated costs of collections. Thus, the accounts receivable will be purchased at a price determined after taking into account those factors normally considered in determining interest to be paid for the advancement of funds. Further, xxxx will purchase such accounts receivable without recourse, assuming all responsibility for collection and all rights for payment on the accounts receivable. Under these facts, all amounts received by xxxx as payments on xxxx and xxxx accounts receivable, in excess of the amounts paid for the accounts

receivable, will be considered compensation received by xxxx in exchange for the use of xxxx's money. Such amounts will, therefore, be interest for purposes of the IITA and allocated to Illinois according to IITA Section 304(c)(1)(C).

Under IITA Section 304(c)(1)(C), interest received in Illinois from Illinois customers is considered business income from sources within Illinois. The term "customer" is not defined in the IITA. Such a definition is the proper subject for rulemaking, but as of yet no administrative rule has been promulgated defining such term. As well, no other relevant authority has defined the term. However, pending the promulgation of a regulatory definition, under the facts presented in your letter request, the obligors on the accounts receivable purchased by xxxx will be considered the customers of xxxx. The obligors are all customers of xxxx and xxxx, both of which will be making credit sales with the expectation of selling the accounts receivable to xxxx, in a continuation of the present business engagement with xxxx. Because xxxx is affiliated with xxxx and xxxx and will be buying the accounts receivable (rather than making a loan to xxxx or xxxx secured by the accounts receivable) in transactions anticipated at the time the accounts receivable are created, the obligors on the accounts receivable will become customers of xxxx at the time the accounts receivable are sold.

The terms "Illinois customers" and "received in this State" as used in IITA Section 304(c)(1)(C) are also not defined in the IITA or any administrative rule. No other relevant authority has defined the terms. Pending the promulgation of regulations on this issue, the following principles should be applied. First, the term "Illinois customer" will include any individual customer who is a resident of Illinois and any person (other than an individual) who is commercially domiciled in Illinois. If the taxpayer has no actual knowledge of the residence or commercial domicile of a customer, the customer will be presumed (subject to rebuttal) to be an Illinois customer if the billing address of the customer is in Illinois. Second, interest from Illinois customers will be "received in this State" if the payment is sent by the customer to a lockbox located in Illinois, or the electronic funds transfer from the customer is directed to a bank located in Illinois.

Applying these principles to the facts presented in your letter request, the amounts received by xxxx from customers as payment on accounts receivable purchased from xxxx and xxxx, in excess of the amounts paid by xxxx for the accounts receivable, will be interest income which will be sourced to Illinois if:

- (a) the customer is:
 - (i) an individual Illinois resident; or
 - (ii) a person (other than an individual) whose commercial domicile is in Illinois; or
 - (iii) (subject to rebuttal) any person whose billing address is in Illinois if xxxx has no knowledge of the person's residence or commercial domicile; and
- (b) the customer's payment is:
 - (i) sent by the customer to a lockbox in Illinois; or
 - (ii) transmitted by the customer electronically to a bank located in Illinois.¹

Therefore, xxxx's business income will be apportioned to Illinois based upon an apportionment formula, the numerator of which is the sum of interest income received at an Illinois lockbox and/ or by electronic transmittal to a bank located in Illinois from (former) xxxx and (former) xxxx customers that are residents of Illinois, commercially domiciled in Illinois, or, where xxxx has no

knowledge of residence or commercial domicile, persons whose billing addresses are in Illinois, and the denominator of which is the sum of all interest income received from all sources.

Duty of xxxx to file an Illinois Return

Section 502(a)(2) of the IITA provides:

A return with respect to the taxes imposed by this Act shall be made by every person for any taxable year:

- (1) For which such person is liable for a tax imposed by this Act, or
- (2) In the case of a resident or in the case of a corporation which is qualified to do business in this State, for which such person is required to make a federal income tax return, regardless of whether such person is liable for a tax imposed by this Act...

xxxx expects to receive interest payments in Illinois from Illinois customers, requiring the apportioning of income to Illinois, and thus creating the expectation of an income tax liability on its Illinois income for which a return must be filed under Section 502(a)(1) of the IITA. Further, xxxx anticipates moving its commercial domicile to Illinois, and, it is assumed, will become qualified to do business in Illinois. xxxx will, therefore, be required under Section 502(a)(2) to file an income tax return if it is required to make a federal return, regardless of whether xxxx has an income tax liability.

Since xxxx will be considered a sales finance company, and thus a financial organization for purposes of the IITA, xxxx will be required to use the apportionment formula for financial organizations under IITA Section 304(c). Section 1501(a)(27) of the IITA provides that:

In no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304 except that for years ending on or after December 31, 1987 this prohibition shall not apply to a unitary business group composed of one or more taxpayers all of which apportion business income pursuant to subsection (b) of Section 304, or all of which apportion business income pursuant to subsection (d) of Section 304, and a holding company of such single-factor taxpayers...

xxxx, as stated above, will be required to apportion income under Section 304(c). Presumably, xxx, the holding company and parent of xxxx, currently apportions income under a separate subsection of Section 304, although the facts presented do not state this. Thus according to Section 1501(a)(27), xxxx and xxx are barred from being members of the same unitary business group, and xxxx will be required to file a separate return from that of xxx's unitary business group.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

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Very truly yours,

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¹ It should be noted that payments made by a credit card company (or other third party) on behalf of a customer are payments from the customer, and should be sourced according to the same rules as payments made directly by the customer.